

Rainmaker

Kathy Xu, founder of Shanghai's Capital Today Group, bridges the gap between Beijing bureaucracy and China's private equity groups | By Stephen Glain

THE MEETING WAS GOING nowhere. For months private equity specialist Kathy Xu had been tracking the success of Gao Mengzhong, the founder of China's leading staff-outsourcing firm. The first time she cold-called him to discuss a partnership, he had politely begged off. Last June, when Xu finally got her foot in the door of Gao's Suzhou office, he was stiff and uncommunicative. He didn't need investment capital, he told her. His company, Huishi Manpower, was profitable. It had no debt, and he was paying dividends each year. The pauses in the conversation seemed interminable.

Finally Xu had had enough. She told Gao that Huishi Manpower, though good, could be even better and she was prepared to write him a check for \$10.5 million to prove it. Otherwise, she'd write one for Gao's closest competitor. That rival could then raise its salaries to \$425 a month, compared with Huishi's base pay of \$280, and incur losses as it expanded its market share. Eventually, she told Gao dryly, it would overtake Huishi.

After one more long pause, Gao asked Xu to lunch. It lasted five hours. Several months later a 20% share of Huishi Manpower became the latest asset in Xu's growing portfolio.

Gao is in good company. Xu, the founder of Shanghai private equity firm Capital Today Group and a key interlocutor between official Beijing and China's cantonment of private equity specialists, is known informally as Tie Niangzi, the "iron lady" of rainmakers. Last year, she says, the 11 companies in her China fund generated an average revenue growth of 141% (she won't disclose the size of the

fund). None of them are listed, and she doesn't expect her first initial public offering for another couple of years. That's roughly when the fund's five-year investment period ends, and backers—which include the International Finance Corp., the World Bank's investment arm; London's Caledonia Investments and Switzerland's Partners Group—can begin expecting returns. The payoff for investors, she says, "is the big money from an IPO or sale."

The 41-year-old Xu, who grew up in once sleepy Sichuan province, where the people are known to be as piquant as the peppery food for which they are famous, is playing the long game. In China intellectual property laws are so porous even the best products can get caught in an unwinnable price war with knockoffs. Success requires a strong brand, says Xu, and strong branding takes time. "A good brand gives you pricing power," she says during a recent visit to Beijing for a quick round of meetings with entrepreneurs and board members. "With a good brand you can expand your market share to the point where your competitor will never catch you." It's also a strategy that's vindicated by the current storm of market instability.

Xu targets prospective assets by studying a market and its half-dozen or so leading companies for three to six months. By the time she makes her fateful cold call, Xu knows the business better than its top performers. Three-quarters of the calls yield at least a first meeting, she estimates. Once she buys a stake in the targeted company, usually putting up \$10 million to \$40 million, she helps it develop an upmarket brand name that no rival can afford to match. Capital Today companies

tend to have little debt and they withhold dividends in favor of capital investment. "It's a build-and-hold strategy," she says, "not a quick flip."

Xu radiates a quiet intensity and has a flair for free-market sloganeering. Like a plant manager rallying laborers to meet production quotas in the latest Five Year Plan, she dares clients and partners alike in meetings and memos to be "Audacious, Heroic and Visionary." In each asset added to her portfolio, she aims to cultivate a "wolf" culture—a killer instinct for meeting customer needs and exploiting market opportunities.

It's a persona she honed as Baring Private Equity Partners' top China female rainmakers, where she crafted the group's debut mainland deals. Her departure in 2005 to launch Capital Today arched more than a few eyebrows. Until then few mainland Chinese had bolted a big foreign firm to set up their own shop. But Xu's timing was perfect: China's stock markets were primed to begin a lucrative ascent after trundling through a five-year funk. Today she has two partners and 20 employees. "It took vision and courage because no one knew you could raise money for independent firms," says Ludvig Nilsson, managing partner of Shanghai investment manager Jade Invest.

Until recently it seemed that China's private equity industry would thrive indefinitely as a small but lucrative subculture in an otherwise highly regulated financial sector. The business was developed in the 1990s by the big Western players—Goldman Sachs, Morgan Stanley—and a number of homegrown firms operating from Hong Kong and buying and selling in U.S. dollars. Back then firms



could freely transfer the ownership of Chinese assets to Cayman Islands-registered holding companies and then sell them or list them on a market of their choice, a process known as "round-tripping." Many of the top dealmakers were arrivistes—second- and even third-generation members of the Chinese diaspora who leveraged their heritage and M.B.A.s for a share of a virgin market. Nearly all of them were men who knew more about the exotica of high finance than they did the business culture of mainland China.

mote capital markets at home. A deluge of new and often contradictory regulations followed—and the volume of private equity deals in 2006 dropped to just under half its 2005 level.

As governor of the China Venture Capital Association, Xu worked with regulators to liberalize the investment laws. She and a group of negotiators managed to win some limited concessions only to see the Ministry of Commerce and other agencies repeal them last year. Last November, at a conference of private

communists most of her life, rolls with such mulishness the way an expert parachutist breaks a landing. "The government says we need to build a domestic market and we believe that is a reasonable proposition," she says, sipping a cup of green tea between meetings at Beijing's China World Hotel. "So for now, we're focusing on onshore deals."

It is a respectful, composed response from an authentic daughter of the revolution, both the communist one she was born into and the capitalist one that has

Homegrown Deal Makers

Kathy Xu's Capital Today Group is just one of a growing firmament of private-equity stars in China.

CDH INVESTMENT

Founded in 2002 by Wu Shangzhi, a former World Bank official. Headquartered in Beijing. Holds \$2 billion worth of equity in Chinese companies. Was an early investor in Inner Mongolia's Mengniu Dairy, one of China's leading milk-product makers, and realized a fourfold return when the company listed in Hong Kong. Along with Goldman Sachs, CDH reaped \$100 million from the 2006 Nasdaq listing of Shanghai's Focus Media. Has now set its sights on China's education sector. In October paid \$10 million for Beijing's Xueda Education Technology, which offers tutoring services for primary and secondary students.

LEGEND CAPITAL

A subsidiary of Legend Holdings, the parent of computer-maker Lenovo. Debuted in 2001 and now manages three funds with investments worth \$300 million in China businesses, largely in IT. Has more than 60 companies in its portfolio, include Web retailer Joyo.com, which was sold to Amazon.com in 2004 for \$75 million, and Solarfun Power and Spreadtrum Communications, which both trade on the Nasdaq.

TSING CAPITAL

Brainchild of Dong Ye, the dean of China's emerging "green" investors, who had moved from Silicon Valley to his native Beijing in 2000. Put \$3 million into China Sunergy and \$5 million into LDK—and earned more than 1,000% when the power companies listed on Nasdaq last May. Sees China's pollution-control industry as a huge growth market thanks to China's two-year-old Renewable Energy Law, which aims to boost alternative energy sources. Its China Environment Fund has grown from \$13 million in 2002 to \$150 million last year. Ye is now eyeing China's growing stable of companies that install energy-saving equipment in homes for free but take as profit as much as 50% of each household's savings.

Source: *Forbes Asia research.*

That made Xu—she claimed her English first name from a character in *Noble House*, James Clavell's novel about Hong Kong—exceptional as much for her ethnicity as for her sex. "Kathy has credibility because of her background and because she's clear in her intentions," says Robert Woll, head of the Asia corporate practice and a comanaging partner of the Beijing office of law firm WilmerHale, which has worked with Xu on some of her biggest deals. "She's not perceived as a returnee who's here to make [U.S. private equity firm] Carlyle rich in China."

It was such authenticity that made Xu a natural spokeswoman for her industry once it got too big for Chinese regulators to ignore. In 2005 the government restricted round-tripping in order to pro-

equity investors and venture capitalists in Beijing, Xu stood before a panel of senior regulators and asked if they would ease restrictions on technology-centric Chinese companies listing on the Nasdaq, where such mainland powerhouses as Baidu and Focus Media had gone public when "round-tripping" was still tolerated. But the regulators declared that the restrictions would remain.

In any event, fundraising and deal-making rebounded last year, according to the Zero2IPO Group in Beijing. Some 64 new private equity funds in China—60% more than in 2006—raised \$35.6 billion, a 151% increase. At the same time, \$12.8 billion was invested in 177 deals, a jump of 37%.

Xu, who has dealt with controlling

grown up with her. Xu was raised in Dazhu, near Sichuan's provincial capital of Chengdu. Her father was the general manager of a state-owned auto factory who regularly hosted visitors from the plant to discuss business while Xu poured tea for the guests. "When your father is a GM you always have people over talking about product quality, sales and salaries," says Xu, who easily disarms strangers with a combination of candor, enthusiasm and fierce eye contact. "I listened and learned."

At Nanjing University Xu studied English, a language she knew well having spent so much of her childhood listening to language records on a gramophone her father bought her in the waning days of the Cultural Revolution. She credits her British and American instructors for her

cosmopolitan outlook and self-esteem. One of them, an American woman, made a particularly deep impression. On the first day of class, says Xu, "she walked into the room and said aloud to the students: 'You are unique, you are a marvel. There has been no person like you in the last 500 years and there will be no person like you in the next 500 years.' It was an eye-opening experience for a Chinese student from Sichuan."

After graduating in 1988 Xu was hired as a clerk at the Bank of China's headquarters in Beijing. Merit pay hadn't yet arrived at the state-owned bank—she was paid 78 yuan a month, about \$10, as were the rest of her colleagues. Enthusiastic and diligent, she became a leader of the Communist Youth League and spent tea breaks teaching English to colleagues. Within 18 months Xu was named the bank's best female employee—the honor translates roughly into "Woman Banner Holder"—out of a field of 2,000. She was awarded a certificate and a bed sheet.

In 1992, eager to see the world outside mainland China and ambitious to succeed in business, Xu applied for an entry-level auditor's position at Price Waterhouse's Hong Kong office. Applicants had to take an exam in accounting, a discipline she knew nothing about. Fortunately for Xu, the test was in English, which few of the other applicants understood. After spending several nights reading an entire accounting textbook, she passed the test and was offered the job.

It was a tough transition for a Sichuan girl who had never stepped foot outside China. Back home, bank employees rarely worked past 5 p.m.; in the corporate corridors of Hong Kong, eating dinner at your desk was considered a badge of honor. To make matters worse, Xu was a mainlander from the provinces, the equivalent of a hayseed in Hong Kong. Staff condescended to her as "little cousin," a reference to the lead role in *Hello Cousin*, a hit film at the time about a mainland girl who gets overwhelmed by the chaos and glamour of Hong Kong. "There was a bias against mainlanders in Hong Kong," says Xu. "We didn't even speak Cantonese."

Having worked so hard to get out of Sichuan, Xu found herself with little to do.

So she adopted Price Waterhouse's Japanese clients, an orphaned portfolio of small business owners who spoke reasonably good English. Her time sheet quickly filled up.

After three years Xu joined Peregrine Direct Investment, the private equity arm of the upstart investment bank. Chinese capital markets had sprung to life, and Xu was dividing her time between Peregrine's Hong Kong headquarters and the mainland. After Peregrine fell victim to the 1997-98 Asian currency collapse, she was hired by Baring, where she became a formidable turnaround artist.

Following the collapse of the global dot-com bubble, Xu helped revive

Xu expects to take Kung Fu public in 2010. **"A lot of bankers are chasing it. But what's the rush?"**

Guangzhou Internet service provider NetEase, a Baring portfolio company that was listed on Nasdaq in 1999. Working with NetEase's 28-year-old founder, William Ding Lei, Xu retooled the company into one of China's leading online gaming and advertising vehicles. Within two years its stock was trading above \$80 a share, up from its low of 60 cents. In 2003 FORBES named Ding the richest man in China. By then Xu had delivered Baring an eightfold return on its investment.

Next Xu homed in on ChinaHR, an online recruiter dogged by leadership problems and stagnant revenue growth. She overhauled the company's management and in 2004 tapped Jason Zhang, then a 41-year-old vice president of human resources at telecom giant Huawei Technologies, as its chief executive. Her offer to Zhang was more a dare than an enticement. "I told him he'd have to put his own money in the company and live off the equity because he'd have a low salary," she says. "So he sold his house and went to work."

As an indication of the premium Xu places on marketing, she paid ChinaHR's marketing manager more than she did Zhang. She boosted its capital with the help of a few rich "angel" investors. The company eventually caught the eye of Monster.com's Andrew McKelvey, who was eager for his jobs site in the U.S. to get a foothold in China. During a conference call in the fall of 2004 Xu and McKelvey immediately clicked.

Within six weeks McKelvey agreed to buy a 40% stake in ChinaHR for \$50 million—\$35 million of which went directly to the angel shareholders—despite the company's meager earnings and the absence of a big investment bank in Xu's corner. The deal inked, a very pregnant Xu went straight to the nearest HSBC branch to ensure that the wire transfer to each of the angel investors was handled properly. The next day she checked into a hospital and delivered her second son.

In each of the last three years, according to Xu, ChinaHR's revenue has doubled. Zhang remains at the company helm, where he's presided over a staff increase from 5 employees to 1,400.

Xu is now training her sights on China's retail sector, a growth market in a country where private consumption accounts for only 38% of gross domestic product, compared with 70% in the U.S. She recently invested \$11 million in Xiangyi, a \$14 million-a-year herbal cosmetics seller. Her first step was to have the sales teams report their revenue figures every 24 hours instead of every month, with the top gainers identified each day by email.

Xu has also sunk \$11 million into Kung Fu, a fast-food company with 245 outlets, no debt and ambitions to replace KFC as China's most popular food-and-beverage chain within the next decade. Kung Fu University, where new hires will be trained and senior employees will learn new management skills, is under construction next to the company's headquarters in Guangdong province.

Xu expects to take Kung Fu public in 2010, in what could be her first IPO. "A lot of investment bankers are chasing it," she says. "But what's the rush? We're in no hurry."

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